



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

200807023

NOV 20 2007

Uniform Issue List: 401.00-00

T:EP: RA: T3

LEGEND:

State A = ***

Statutes B = ***

System C = ***

Dear ***

This is in response to a request for a private letter ruling dated August 8, 2006, and supplemented by faxed letter dated January 22, 2007, submitted on your behalf by your authorized representatives regarding the tax consequences of amendments to certain distribution provisions contained in System C and the continued eligibility for grandfather relief from the provisions of the Final Regulations issued by the Internal Revenue Service under section 401(a)(9) of the Internal Revenue Code of 1986 ("Code"). Your authorized representatives have submitted the following facts and representations in connection with this request.

Article 2 of Chapter 5, Title 38, Statutes B established System C for the benefit of eligible employees of State A and its political subdivisions. On April 18, 2001, the Service issued a letter of determination for System C finding that System C is a plan qualified under section 401(a) of the Code,

System C is a governmental plan, as described in section 414(d) of the Code. System C is also defined a benefit plan as defined in sections 414(j) and 414(k) of the Code since System C not only provides a defined benefit to its members but also provides a benefit for certain eligible members derived from employee and employer contributions which is based on the balance of each such members' account. In other words System C contains both a defined benefit and defined contribution element.

In 1985, the State A Legislature adopted the predecessor to Statutes B section 38-736B (formerly Statutes B section 38-781.04D) directing all employers of System C members to pick up the mandatory member contributions. On May 5, 1986, the Service issued a private letter ruling to System C concluding that the amounts picked up by the employers satisfied the requirements of section 414(h)(2) of the Code. Accordingly, System C is a qualified "pick-up" plan described in section 414(h)(2) of the Code.

As of June 30, 2005, System C covered 212,000 active members, 150,000 inactive members and 74,000 retired members. Membership includes state employees, teachers and employees of political subdivisions of State A. Average annual pay for active members in fiscal year was \$.

From its inception, System C has allowed a retired member who elected a joint and survivor form of retirement benefit to rescind his election and "pop-up" to a single life benefit, provided the retired member could demonstrate evidence of good health. In 1994, the State A Legislature removed the good health requirement and in 2001, the State A Legislature extended the "pop-up" to members who elect life with a term certain form of pension. Members can "pop-up" at any time after retirement, regardless of whether their beneficiaries are alive or dead. Members who have "popped-up" are allowed to "pop-down" to their original forms of pension (and, if they wish, to name new beneficiaries) at any time. There is no limit to the number of times a member can "pop-up" and "pop-down." These rules are contained in Statutes B sections 38-760 B.1 and B.2. System C believes that these provisions have always complied with section 401(a)(9) of the Code based on a reasonable and good faith interpretation of the provisions of Code section 401(a)(9).

In the 2006 State A Legislature Session, the State A Legislature adopted amendments to Statutes B sections 38-760 B.1 and B.2. The amendments are contained in Senate Bill ("SB") 1167 (47th Legislature, Second Regular Session, 2006). The amendments changed the "pop-up" rules for members who retire after the effective date of the amendments by allowing members who had elected a joint and survivor option of life with a term certain option to make a one-time election to revoke the prior election and "pop-up" to a single life annuity. In addition, the member can elect a pop-up benefit only if the member's joint annuitant or term certain beneficiary dies or ceases to be the joint annuitant or term certain beneficiary pursuant to the terms of a qualified domestic relations order. Finally, the amendments would disallow all "pop-downs."

Thus, a member who retires after the effective date of the amendments and elects to "pop-up" would receive the single life distribution amount for the remainder of his life. The intention of the amendment is to eliminate the cost associated with allowing members to "pop-down" when they reach the end of their lives – members who currently do so receive death benefits without paying

for them, and the cost is transferred to participating employers and active members in the form of higher contribution requirements.

Section 4 of SB 1167 provides that the amendments contained in SB 1167 will become effective only if System C obtains a private letter ruling from the Service by July 1, 2009, finding that the amendments do not cause any form of benefit in System C to lose the grandfathering provisions for governmental plans contained in the final Treasury Regulations issued by the Service under section 401(a)(9) of the Code.

Based on the foregoing facts and representations, your authorized representatives have requested the following rulings:

1. The amendments contained in SB 1167 to Statutes B sections 38-760 B.1. and B.2. comply with the rules contained in Treasury Regulations ("Regulations") section 1.401(a)(9)-6, Q&A-14, which sets forth the conditions under which annuity payments are permitted to increase.
2. The amendments contained in SB 1167 to Statutes B sections 38-760 B.1. and B.2. will not cause any form of benefit contained in Statutes B section 38-760 to lose the grandfathering provisions for governmental plans contained in the final Treasury Regulations issued by the Service under section 401(a)(9) of the Code.

The definition of a "governmental plan" is set forth in section 414(d) of the Code which states that it is a plan established and maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing.

Code section 414(h)(2) states that in the case of a governmental plan where the contributions of employing units are designated as employee contributions but where any employing unit picks up the contributions, the contributions so picked up shall be treated as employer contributions. These types of plans are often referred to as "pick-up" plans.

Section 401(a)(9) of the Code contains the rules setting forth the minimum distribution requirements applicable to plans qualified under section 401(a) of the Code. These rules also apply to governmental plans.

In order to satisfy section 401(a)(9) of the Code distributions of the employee's entire interest under a defined benefit plan must be paid in the form of periodic annuity payments for the employee's life (or the joint lives of the employee and beneficiary) or over a period certain that does not exceed the maximum length of the period certain as defined in Regulations section 1.401(a)(9)-6, Q&A-3. Once payments have begun the period may only be changed in accordance with Regulations section 1.401(a)(9)-6, Q&A-13 and life (or joint and survivor) annuity

payments must satisfy the minimum distribution incidental benefit requirements of Regulations section 1.401(a)(9)-6, Q&A-2. Except as otherwise provided in this section, payments must not increase. *Regulations section 1.401(a)(9)-6, Q&A-1.*

Regulations section 1.401(a)(9)-6, Q&A-14 states in relevant part that annuity payments may increase to the extent of the reduction in the amount of the employee's payments to provide for a survivor benefit, but only if there is no longer a survivor benefit because the beneficiary whose life was being used to determine the required distribution period, as defined in section 401(a)(9)(A)(ii) of the Code, over which payments were being made dies or is no longer the employee's beneficiary pursuant to a qualified domestic relations order with the meaning of section 414(p) of the Code.

Regulations section 1.401(a)(9)-6, Q&A-16 states that an annuity distribution option provided under the terms of a governmental plan in effect on April 17, 2002 will not fail to satisfy section 401(a)(9) of the Code merely because the annuity payments do not satisfy Regulations section 1.401(a)(9)-6, Q&A-1 through 16, provided the distribution option satisfies section 401(a)(9) of the Code based on a reasonable and good faith interpretation of the provisions of section 401(a)(9) of the Code.

New regulations issued by the Service under Regulations section 1.401(a)(9)-6 Q&A-17 extends the protection of Regulations section 1.401(a)(9)-6, Q&A-16 for plan years beginning January 1, 2006 as long as the distribution rules in effect in prior years satisfy section 401(a)(9) of the Code based on a reasonable and good faith interpretation of the provisions of section 401(a)(9) of the Code.

With regard to ruling request 1, in Senate Bill 1167 (47th Legislature, Second Regular Session, 2006) the State A Legislature adopted amendments to Statutes B sections 38-760 B.1 and B.2. These amendments state that, "A member whose original date of retirement is on or after the effective date of this amendment to this section may exercise a one-time election to rescind the joint and survivor annuity option elected by the member if the contingent annuitant dies or ceases to be a contingent annuitant pursuant to the terms of a qualified domestic relations order." We believe this amendment complies with the rules contained in Regulations section 1.401(a)(9)-6, Q&A-14, which sets forth the conditions under which annuity payments are permitted to increase.

With regard to ruling request 2, the State A Legislature has adopted conditional amendments to the pop-up and pop-down provisions of Statutes B section 38-760, which will apply to any member who retires on or after the effective date of the amendments. As stated above, we believe these amendments comply with the rules contained in Regulations section 1.401(a)(9)-6, Q&A-14. As such, we also believe that limiting the pop-up elections of future retirees to only the two events described in Regulations section 1.401(a)(9)-6, Q&A-14 will not cause

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System C to lose the special grandfathering provisions applicable to governmental plans contained in Regulations section 1.401(a)(9)-6, Q&A-16, applicable to pop-up and pop-down elections by members who retire before the effective date of SB 1167 because these benefits were in effect on April 17, 2002.

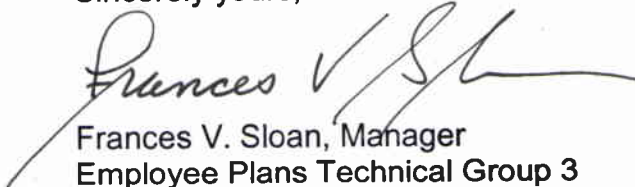
This ruling applies to participants of both the defined benefit plan and defined contribution plan of System C.

This ruling letter is directed solely to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

A copy of this ruling letter is being sent to your authorized representative in accordance with a power of attorney on file in this office.

If you wish to inquire about this ruling, please contact *** (ID ***) at ***.
Please address all correspondence to SE:T:EP:RA:T3.

Sincerely yours,


Frances V. Sloan, Manager
Employee Plans Technical Group 3

Enclosures:

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Form 437

CC:

